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No. 95-1232

IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1995

GENERAL MOTORS CORPORATION,
Petitioner,

v.

ROGER W. TRACY, TAX COMMISSIONER OF OHIO,
Respondent.

On Writ of Certiorari to the Supreme Court of Ohio

BRIEF OF THE PROCESS GAS CONSUMERS GROUP AND THE NATURAL GAS SUPPLY ASSOCIATION AS AMICI CURIAE IN SUPPORT OF PETITIONER

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19 pp

TABLE OF CONTENTS

INTEREST OF AMICI CURIAE 1

The Context of This Proceeding: The Natural Gas Industry Today 3

SUMMARY OF ARGUMENT 6

ARGUMENT 7

The Exemption For "Natural Gas Companies" From Ohio's Sales and Use Tax Impermissibly Discriminates Against Interstate Commerce. . . . 7

A. The Ohio Taxing Scheme Unmistakably Discriminates Against Interstate Commerce 7

B. The Court Below Upheld the Ohio Taxing Scheme by Applying an Erroneous Test 11

C. Ohio's Reliance on *Amerada Hess* is Misplaced 13

CONCLUSION 15

TABLE OF AUTHORITIES

Constitution: *Page*

Commerce Clause of the United States Constitution, art. I, sec. 8, cl. 3 7

Cases:

Amerada Hess Corp. v. *Director, Div. of Taxation*, 490 U.S. 66 (1989) 6-7, 13-14

Associated Industries of Missouri v. *Lohman*, 114 S. Ct. 1815 (1994) 11

Bacchus Import, Ltd. v. *Dias*, 468 U.S. 263 (1984) . . . 12

Boston Stock Exchange v. *State Tax Commission*, 429 U.S. 318 (1977) 6, 9-11

Chrysler Corp. v. *Tracy*, 652 N.E. 2d 185 (Ohio 1995) 8

Dean Milk Co. v. *City of Madison*, 340 U.S. 349 (1951) 12

Fulton Corp. v. *Faulkner*, 116 S.Ct. 848 (1996) 11

Westinghouse Electric Corp. v. *Tully*, 466 U.S. 388 (1984) 6, 9-11

Statutes:

Ohio Rev. Code Ann. section 5739.02(B)(7) 8

Table of Authorities Continued

Orders:

Order No. 436, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, 50 Fed. Reg. 42408 (Oct. 18, 1985), FERC Stats. 4 Regs. [Regulations Preambles 1982-1985] ¶ 30, 665 (1985) 4

Order No. 636, Pipeline Service Obligations and Revision to Regulations Governing Self-Implementing Transportation and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, 57 Fed. Reg. 13267 (1992), *appeal pending sub nom., United Distribution Cos.* v. *FERC*, No. 94-1485 (D.C. Cir.). 4

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INTEREST OF AMICI CURIAE

The Process Gas Consumers Group ("PGC") is a non-profit national association consisting of industrial corporations that require natural gas in many of their key operations. Organized in the District of Columbia in 1978, PGC works

to promote coordinated, rational and consistent federal and state policies relating to natural gas and its transportation.

PGC has 17 member companies that represent a broad cross-section of U.S. industry, both geographically and in terms of products produced. Their combined operations -- located in 34 states and employing approximately 1.5 million people -- consume approximately 450 billion cubic feet of natural gas annually.

The Natural Gas Supply Association ("NGSA") represents integrated and independent companies that produce and market domestic natural gas. Established in 1965, NGSA encourages expanded use of natural gas and a regulatory climate that fosters competitive markets. NGSA's members sell natural gas to marketers, local distribution companies, and consumers. Some of NGSA's members also operate refining and manufacturing facilities that consume substantial quantities of natural gas.

A number of PGC's members have manufacturing facilities in Ohio and purchase natural gas from out-of-state sources. Many NGSA members sell natural gas that is used by Ohio consumers. Thus, each organization has a decided interest in the outcome of the instant case.

Beyond the immediate impact of the Ohio tax at issue, PGC and NGSA are very concerned about any state tax schemes that discriminate against natural gas sales by out-of-state marketers and producers. As discussed below, today's natural gas markets are national in scope but could be quickly balkanized if states are permitted to use tax schemes to tilt markets in favor of in-state sellers. The disruptions of interstate natural gas markets that would result from such

discrimination would be harmful to both gas users and gas producers throughout the country.

PGC and NGSA submit this brief *amici curiae* in support of petitioner.[1/]

The Context of This Proceeding: The Natural Gas Industry Today

Today's natural gas industry is radically different from the natural gas industry that existed in the past. Twenty years ago, natural gas sales to consumers were made almost entirely by local distribution companies ("LDCs"), which in turn purchased almost all of their gas from interstate pipelines. Today, largely as a result of federal policies implemented beginning in the 1980's, many large users purchase natural gas directly from independent marketers and producers in interstate transactions. Indeed, even some small commercial entities, including schools and hospitals, now purchase their gas from entities other than the traditional LDCs. Thus, in today's environment, LDCs compete directly with producers and marketers for natural gas sales to local consumers. Gas producers and marketers frequently operate in states other than the state of ultimate use, and many sales thus take place outside the state of ultimate use, with the buyer responsible for arranging transportation to the point of consumption.

Competition for sales to natural gas users has developed as a result of the natural gas transportation revolution of the last ten years. Beginning in the mid-1980's,

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[1/] Both petitioner and respondent have consented to the filing of this brief *amici curiae* in letters lodged with the Clerk of this Court.

the Federal Energy Regulatory Commission ("FERC") encouraged interstate pipelines to transport, on an "open access" basis, natural gas sold by sellers other than the pipelines themselves.[2/] Pursuant to the FERC's "open access" transportation policies, consumers, LDCs and any other interested entity can arrange with an interstate pipeline for the transportation of natural gas purchased from any producer or independent marketer.

In 1992, the FERC further revised its open access transportation regulations to *require* contract carriage of gas by interstate pipelines and to complete the unbundling of the interstate pipelines' merchant and transportation functions.[3/] Now, as a practical matter, interstate pipelines are no longer in the merchant business; they perform only contract carriage services on behalf of any willing shipper of gas, including LDCs, commercial and industrial gas users, and natural gas marketers.

[2/] Prior to 1985, the FERC authorized limited programs for interstate pipelines to transport gas purchased by users and LDCs directly from gas producers and independent marketers. Those programs were then expanded in late 1985 to provide "open access" transportation on behalf of any willing shipper without discrimination against any seller or buyer. See Order No. 436, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, 50 Fed. Reg. 42408 (Oct. 18, 1985), FERC Stats. 4 Regs. [Regulations Preambles 1982-1985] ¶ 30, 665 (1985).

[3/] Order No. 636, Pipeline Service Obligations and Revision to Regulations Governing Self-Implementing Transportation and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, 57 Fed. Reg. 13267 (1992), *appeal pending sub nom., United Distribution Cos.* v. *FERC*, No. 94-1485 (D.C. Cir.).

Today, most large LDCs offer to transport customer-owned natural gas from the outlet of interstate pipelines to the customer's facilities. However, unlike the interstate pipelines, LDCs also continue to compete with producers and marketers for gas sales to consumers connected to their distribution systems.

In order to be able to sell gas to local consumers, an LDC will itself typically purchase gas from producers and marketers located outside the state in which the LDC's distribution system is located. In addition, some LDCs, including Ohio LDCs, are able to purchase gas from in-state producers of natural gas or are able to produce gas from their own in-state wells that are connected to their local distribution systems.

Natural gas consumers are very sensitive to prices and view total delivered cost as a key factor in their choice of seller. Taxes can be a significant element in the decision if competing sellers' prices are otherwise similar. Any tax scheme that favors in-state sellers or even a subclass of in-state sellers, such as LDCs, over out-of-state sellers will inevitably tilt the competitive market against interstate commerce in natural gas.

The success of the competitive natural gas market that now exists depends upon the ability of buyers and sellers to purchase and sell natural gas without discrimination against interstate commerce in natural gas. Any state-approved tax scheme that discriminates against interstate sellers will ultimately harm both consumers and producers by balkanizing markets for natural gas. It is for that reason that the Process Gas Consumers Group and the Natural Gas Supply

Association -- organizations whose members are located at both ends of the interstate natural gas system -- submit this brief *amici curiae*.

SUMMARY OF ARGUMENT

The Ohio sales and use taxing scheme patently discriminates against interstate commerce by providing an exemption that benefits only local public utilities, to the detriment of out-of-state independent marketers and producers of natural gas. For that reason, it must be struck down based on a long line of cases.

Two cases in particular support the conclusion that the Ohio sales and use taxing scheme is unconstitutional -- *Boston Stock Exchange* v. *State Tax Commission*, 429 U.S. 318 (1977) and *Westinghouse Electric Corp.* v. *Tully*, 466 U.S. 388 (1984). In both cases, this Court struck down taxing schemes that had the effect of encouraging transactions to be consummated in the home State to the detriment of interstate commerce. The exemption to the Ohio sales and use tax has the identical effect.

The Ohio Supreme Court's test for discrimination under the Commerce Clause was flawed because it focused solely on the application of the tax exemption to independent marketers. Instead, the Ohio Supreme Court should have focused on who was eligible for the tax exemption.

Finally, respondent improperly relies on *Amerada Hess Corp.* v. *Director, Div. of Taxation*, 490 U.S. 66 (1989), to support its assertion that the difference between Ohio public utilities and independent marketers and producers justifies their disparate treatment. Unlike the situation here,

the tax scheme at issue in *Amerada Hess* did not have the effect of encouraging or favoring any particular type of local activity.

ARGUMENT

The Exemption For "Natural Gas Companies" From Ohio's Sales and Use Tax Impermissibly Discriminates Against Interstate Commerce.

Article I, §8, cl.3 of the U.S. Constitution gives the Congress the power, "To regulate Commerce with foreign Nations, and among the several states, and with the Indian Tribes." Under this Court's Commerce Clause analysis, a state taxing scheme will be struck down if it discriminates against interstate commerce.

Amici believe it is clear that the structure of the Ohio sales and use tax, with its exemption for "natural gas companies" as that term has been defined, discriminates against out-of-state purchases of natural gas and thus violates the Commerce Clause.

A. The Ohio Taxing Scheme Unmistakably Discriminates Against Interstate Commerce

Large consumers of natural gas in Ohio have two choices of suppliers from which to purchase natural gas -- independent natural gas producers or marketers and LDCs. Regardless of from which entity a consumer ultimately chooses to purchase its natural gas, the gas will generally be

delivered to the consumer by local distribution pipelines that are owned by the LDCs.[4/]

From the consumer's perspective, because each of the two classes of suppliers offers the identical product (*i.e.*, natural gas) and delivers the natural gas in essentially the identical manner (*i.e.*, through local distribution pipelines owned by the LDCs), the purchase price of the natural gas is a significant factor in the consumer's purchasing decision.

Ohio exempts from its sales and use tax only purchases of natural gas from "natural gas companies," defined as suppliers which themselves also deliver the natural gas to their customers in Ohio. *See* Ohio Rev. Code Ann. section 5739.02(B)(7); *Chrysler Corp.* v. *Tracy*, 652 N.E. 2d 185 (Ohio 1995). In other words, to qualify for the tax exemption, the gas must be sold and delivered to the consumer by the same entity. Because the LDCs own the local distribution pipelines and are therefore the only sellers of natural gas that can also deliver gas to consumers in Ohio, sales of natural gas by the LDCs are the only sales eligible for the tax exemption.

Amici see no need to restate Petitioner's thorough discussion of the relevant decisions of this Court that prohibit a state from imposing a tax which discriminates against interstate commerce by providing a direct commercial advantage to local business. *Amici* do, however, wish to

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[4/] In a few instances, industrial users have been able to install gas lines that run directly from an interstate pipeline to their plants, thereby avoiding the local distribution pipelines. However, the vast majority of natural gas purchased by industrial users in Ohio is delivered through pipelines owned by the LDCs.

emphasize the relevance to the instant case of this Court's decisions in *Boston Stock Exchange* v. *State Tax Commission*, 429 U.S. 318 (1977) and *Westinghouse Electric Corp.* v. *Tully*, 466 U.S. 388 (1984).

Boston Stock Exchange struck down a New York tax on stock transfers that discriminated against stock sales made outside of New York in favor of sales made in New York. Sellers of stock, wherever located, had the option of selling their shares on either the New York Stock Exchange or on one of several "regional" stock exchanges. The effect of the New York stock transfer tax scheme was to encourage stock sales on the New York Stock Exchange. The New York stock transfer tax thus had the effect of influencing a seller's decision as to where to consummate the sale.

In a parallel to the tax scheme involved in *Boston Stock Exchange*, the exemption from the Ohio sales and use tax affects the Ohio gas consumer's decision as to where to consummate its purchases. The Ohio gas consumer has the option of entering into a transaction with either an LDC or an independent marketer or producer. If the consumer selects an out-of-state marketer, it will *always* be subject to the use tax. If the consumer selects an LDC, its purchase will be tax-exempt.

Under both the New York and Ohio schemes, a tax benefit could be enjoyed if the activity in question (selling stock or purchasing gas) occurred locally, and a tax detriment would result if the activity occurred outside the state. The result in both cases unquestionably is to encourage the affected parties to avail themselves of the favored local

option. That constitutes unconstitutional discrimination against interstate commerce.[5/]

In *Westinghouse Electric*, this Court struck down New York's franchise tax provision that governed the tax treatment of income earned from export sales made through a Domestic International Sales Corporation (DISC). This Court concluded that the taxing scheme favored DISC sales made through New York, to the detriment of DISC sales made from other locations. As this Court stated:

> Whether the discriminatory tax diverts new business into the State or merely prevents current business from being diverted elsewhere, it is still a discriminatory tax that "forecloses tax neutral decisions and...creates...an advantage" for firms operating in New York by placing "a discriminatory burden on commerce to its sister states." *Boston Stock Exchange*, 429 U.S., at 331.

466 U.S. at 406.

Drawing further upon its reasoning in the earlier case, this Court added:

[5/] Even if the gas sold by an LDC were viewed as "interstate gas" to the extent it originated outside the State, as would be the case with gas sold by an out-of-state marketer, *Boston Stock Exchange* requires that the Ohio taxing scheme be struck down because a State may not tax "in a manner that discriminates between two types of interstate transactions in order to favor local commercial interests over out-of-state business...." 429 U.S. at 335.

> The State has violated the prohibition in *Boston Stock Exchange* against using discriminatory state taxes to burden commerce in other States in an attempt to induce "business operations to be performed in the home State that could more efficiently be performed elsewhere...." (citations omitted).

Id.

The analysis of the New York taxing scheme set forth in *Westinghouse Electric* is directly applicable to the Ohio taxing scheme at issue in the instant case. The effect of the tax exemption granted for sales made by LDCs in Ohio is to induce consumers to make their gas purchases from such local suppliers, to the detriment of out-of-state producers and marketers. A taxing scheme with such a discriminatory design is simply not permitted under the Commerce Clause.[6/]

B. The Court Below Upheld the Ohio Taxing Scheme by Applying an Erroneous Test

The Ohio Supreme Court saw no impermissible discrimination in the Ohio taxing scheme on the ground that

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[6/] Respondent suggests that the sales/use tax that is imposed on gas purchases from independent marketers is complementary to the Ohio gross receipts tax imposed on LDCs. (Resp. Br. in Opp. p. 11 n.3.) Under this Court's decision in *Fulton Corp.* v. *Faulkner*, 116 S.Ct. 848, 856 (1996), however, the fact that the 5-7% sales/use tax rate exceeds the 4.75% gross receipts tax rate means that the sales/use tax is not a constitutionally permissible "compensatory" tax. *See also Associated Industries of Missouri* v. *Lohman*, 114 S. Ct. 1815, 1821 (1994). In addition, because the two taxes are imposed on different classes of taxpayers, it would appear under *Fulton Corp.*, 116 S. Ct. at 858, that the taxes could not qualify as complementary taxes for that reason as well.

gas purchased from in-state independent marketers is subject to the sales tax in the same manner that gas purchased from out-of-state independent marketers is subject to the use tax -- neither transaction is eligible for tax exemption because neither type of marketer will itself actually deliver the gas to its customers. The Ohio statute, the court held, thus cannot be said to favor in-state vendors over out-of-state vendors.

The court below erred by focusing solely on the application of the tax exemption to independent marketers. Instead, the Ohio Supreme Court should have focused on who was eligible for the tax exemption. Because the tax exemption is *only* available for in-state purchases of natural gas from LDCs, and because out-of-state purchases (whether from independent marketers or producers) are *never* eligible for the exemption, the Ohio sales and use taxing scheme impermissibly discriminates against interstate commerce in favor of local activity.

The fact that independent marketers within Ohio, like their out-of-state counterparts, are not eligible for the tax exemption is of no significance. This Court has consistently held that a statute will not pass constitutional muster merely because the statute, in addition to disfavoring interstate commerce, also works to disfavor some intrastate commerce. *See, e.g., Bacchus Imports, Ltd.* v. *Dias*, 468 U.S. 263, 271 (1984); *Dean Milk Co.* v. *City of Madison*, 340 U.S. 349, 354 n.4 (1951).

Here, because the exemption from the Ohio sales tax applies only to LDCs, and the exemption from the use tax *never* applies to out-of-state independent marketers, the Ohio

sales and use taxing scheme discriminates against interstate commerce.

C. Ohio's Reliance on *Amerada Hess* is Misplaced

Respondent suggests that the exemption from the Ohio sales and use tax for natural gas sold by LDCs does not run afoul of the Commerce Clause because there is a "legitimate distinction" between LDCs and independent marketers. Respondent cites *Amerada Hess Corp.* v. *Director, Div. of Taxation*, 490 U.S. 66 (1989) as authority for this proposition. (Resp. Br. in Opp. p. 12-13.) *Amerada Hess* does not provide any such support.

Amerada Hess upheld a provision requiring the "add back" of all federal taxes on income and profits, including the windfall profits tax, in the computation of the New Jersey corporate tax base. The windfall profits tax was imposed only on oil producers. Independent retailers, who directly competed with oil producers for sales of petroleum products to New Jersey consumers, were not subject to the windfall profits tax because they were not producers of oil.

The oil producers that sold their products at retail in New Jersey argued that the "add back" of the windfall profits tax to the New Jersey corporate tax base discriminated against interstate commerce because it put them at a disadvantage vis-a-vis the independent non-producing retailers who did not incur the tax.

This Court held that there was no discrimination against interstate commerce in *Amerada Hess* because the windfall profits tax was not imposed based on location, but

rather on the activity of oil production wherever conducted. The "add back" of that tax thus did not have the effect of encouraging oil production (or favoring any other activity) within New Jersey.

Here, however, the "natural gas company" exemption from the Ohio sales and use tax works solely to the advantage of the local distribution companies. No out-of-state sellers of natural gas are eligible for the exemption because no out-of-state sellers have the capability of making local delivery. Consequently, the Ohio taxing scheme clearly discriminates in favor of specific local activity. *Amerada Hess* provides no support for respondent.

* * *

State taxing schemes that have the effect of favoring local interests over interstate commerce cannot pass constitutional scrutiny. If the taxing scheme here at issue is upheld, Ohio and other states will surely be encouraged to enact new and creative schemes of a similar nature, affecting not only natural gas but other industries as well. The free, open and robust interstate competition contemplated by the Framers would then be severely impaired. Opening the door to such a result here would represent a sea change in this Court's treatment of such taxing schemes.

CONCLUSION

For all of the foregoing reasons, the decision of the court below should be reversed.

Respectfully submitted,

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